THE TARIFF OF 1913. III

In what has been said during the former discussions of the tariff of 1913, reference has been had almost exclusively to the provisions of the law relating to duties, to customs administration, and to clauses affecting foreign trade relations. The tariff act of 1913, however, was not only a measure for the revision of import rates and for reorganizing the conditions of importation, but was also a revenue law in the larger sense. As has been incidentally noted in the former discussions already referred to, it was recognized from the beginning that very great tariff changes would necessitate a recourse to new methods of revenue raising, or else to a severe cut in expenditures. That a cut could be successfully and effectively attempted few believed. The overgrown expansion of the federal government, the undertaking of many new functions, and the constant hungry struggle at the patronage trough had swollen annual expenditures to a volume never before dreamed of. To check this tide of extravagance, it was seen, would necessarily be the work of years; and congressional leaders, probably wisely, concluded that they would do well to recognize the facts in the case and to seek for the moment simply to get from some source the funds needed to meet expenditures upon the existing basis. The way had already been pointed out by the Republican Congress which passed the tariff act of 1909. In that Congress, to provide for the ever-growing outlays with which even the tariff was not sufficient to cope, the corporation tax had been proposed and enacted, and its yield during the succeeding years had reached the estimated level. It had proved an easy means of providing at least $30,000,000 on the average. To expand this corporation tax so as to include individual income was a natural and logical step. The plan had, besides, the warrant of past experience; since, in the tariff act of 1894, the notion of redressing the balance of taxation had been given scope through the introduction of an income tax designed to supplement the reduced yields of the tariff act of that year, and estimated to produce $40,000,000. For both logical and historical

reasons, therefore, Democratic leaders turned toward the individual income tax. That they would do so had already been indicated during the Sixty-second Congress when the Ways and Means Committee had reported a bill providing for an individual income tax estimated to produce probably $60,000,000, at the same time that they introduced and passed a bill repealing the tariff on sugar and thereby sacrificing an income of between $50,000,000 and $60,000,000. It was resolved early in the process of actually effecting tariff revision, to revive this income-tax measure and, by amplifying and adjusting it, to render it an effective auxiliary to the revision of the tariff itself. This resolution was carried out, and the act of 1913 became both a tariff and an income-tax law. It thus constituted a very great departure from anything practically in force since the Civil War, inasmuch as the act of 1894 had never taken effect in so far as its income-tax features were concerned; while the income-tax idea, although logically an extension of the corporation tax, constituted, in practice, a very great change from the provisions of that measure. We must, therefore, regard the income-tax legislation of 1913 both from a general theoretical standpoint and from the point of view of technique. No criticism based upon one of these phases of the situation which ignores the other will be adequate, and no estimate of the law of 1913 can be considered sufficient which does not give large significance to certain important aspects of the income-tax sections of the measure.

I

The essential outlines of the income-tax law are simple, though its administration and technique are highly intricate. The former is of larger interest to the student of economics than the latter, although technical questions have their own significance. First and fundamental study should, however, be given to the ideas at the root of the income-tax provision.

The plan of the income tax of 1913 calls for an annual levy of 1 per cent upon all incomes above $3,000, or, in the case of married men with families, upon incomes in excess of $4,000. When incomes exceed $20,000 annually there is provision for a graduated additional or surtax, this being intended to strike at the supposedly

"surplus" power of payment enjoyed by men with incomes greater than that amount. Provision is made for the retention of the income tax of 1 per cent levied upon the net revenues of all corporations with net annual returns in excess of $5,000, so that the corporation-tax idea is accepted and adjusted to the requirements of the new legislation. The measure is, in other words, a general income tax applicable to both individuals and corporations. It is more than this, for it is an effort to redress the supposedly uneven burden of taxation resulting from the use of the tariff as a principal means of obtaining revenue. Further, it is a progressive income tax in addition to being based upon a decidedly high exemption limit. Two questions with reference to the basic idea of the tax thus present themselves: (1) Is this income tax a desirable means of obtaining revenue with which to supplement the yield of the tariff? (2) Is this income tax a useful or desirable means of readjusting the burden of taxation, and has that means been used in such a way as to produce the desired results?

During a former discussion[1] something was said of the income tax in connection with the abolition of the sugar tariff. It was then pointed out that the annual yield of the sugar duties may be taken as about $50,000,000 while, as will later be seen, the estimated yield of the individual income tax is not much more than that, the preliminary figures running only to about $60,000,000 or $70,000,000. If the tariff on sugar had been retained it is clear that the income tax would not have been needed. Certainly if to the sugar tax there had been added a plan for the retention of a very limited number of other duties there could have been little support for belief that the income tax was necessary. It was not, then, any belief that other sources of revenue had been exhausted that led to a resort to the income tax. At no time during the discussion of the tariff of 1913 was there even a remote suggestion of reviving the highly productive inheritance taxes of former years, or the stamp taxes which had produced such enormous revenues in times past, and to which there had been but limited objection on the part of the payers. The decision to take up the income tax was not solely due to the circumstance that in cutting down tariff

[1] *Journal of Political Economy*, XXII, 2 (February, 1914), p. 123.

rates heavy reductions of revenue had been made; on the contrary, the income tax was selected out of several more fruitful sources of revenue as the method for securing certain definite desired results.

In estimating the wisdom of this action, we may consider in their order certain arguments in behalf of the adoption of income taxation by the federal government and certain objections to it.

As favoring the adoption of the tax, it was urged that:

1. Income taxation had become a political principle with the Democratic party. Its temporary adoption in 1894, followed by the subsequent rejection of the plan by the Supreme Court, had left a situation which, from the political standpoint, called for action designed to restore the past prestige of the party in this matter. On the other hand, the constant advocacy of the income tax as a means of redistributing the burdens of support of the government had been a fixed feature of so-called progressive political discussion and effort for years past, and was not confined to the Democratic party.

2. Income taxation has been accepted by nearly every foreign government subject to modern revenue requirements, as a satisfactory means of adjusting the burdens of public support.

3. Income taxation had been specifically constitutionalized by the adoption of the income-tax amendment which had been initiated during the Taft administration and had been passing through the necessary routine of ratification by the states.

4. Income taxation could undoubtedly be made to yield the amount of revenue needed now or likely to be needed in the future by the federal government.

5. Income taxation properly applied would tend to bring home to the individual the constantly growing character of the burden imposed by the federal government.

As against the adoption of the income tax by Congress, the following considerations prominently suggested themselves:

1. The income tax was already employed by several states and was probably needed by them as a regular resource.

2. With divided jurisdiction (between the federal government and the states) there would inevitably be considerable conflict of legislation, resulting in more or less difficulty in the maintenance

of the tax and its appropriate collection. Double taxation, moreover, was likely to occur as a result of the contemporaneous collection of both state and federal income taxes, in spite of all efforts to avoid this danger.

3. At this particular juncture, all the revenue needed could easily be obtained with a less difficult and less annoying kind of tax.

4. The cost of collection of the income tax was certain to be high and the difficulty of gathering it very great, while the consequent inconvenience and unpopularity were almost certain to be large.

5. If a very high limit of exemption were to be adopted, the income tax would not be very productive and probably could not be made so, while if at any time this limit were to be lowered, the result would be a corresponding increase in the annoyance to the individual payer of the tax and in the consequent unpopularity of the tax itself.

6. Many easy methods of getting revenue were within ready reach.

A weighing of these conflicting considerations led the framers of the tariff law to the belief that they ought to include the income tax as a part of their general program. It was most forcibly urged that the party was thoroughly committed to it, that the experience of foreign countries indicated the wisdom of its use, and that legislation should be shaped with a view to the future in the long range sense and not for the sake of protecting purely temporary conditions. As for the revenue problem of the states, it was argued that the government was already committed to the adoption of the income tax in principle without regard to its influence upon state finances by reason of the fact that the corporation tax had been in previous operation four years in spite of the protests of state governments; hence infringement upon state finances, whatever it might be said to be, was already an established fact.

On the whole, the student of federal finance who looks at the subject from the larger standpoint will probably conclude that

this decision was wise. The income tax when properly administered opens a pathway to unlimited resources. It is the avenue through which the federal government should, if it can, make its burden and its presence felt by the average man. It is the kind of tax which when properly constructed can be decreased or increased with the smallest resultant disturbance to industry. With federal expenses growing and likely to grow still more in the near future, it was well to secure a sure means of enlarging revenues in the event of necessity.

The other phase of the income-tax question already referred to presents a quite different problem. In asking whether the income tax will prove a useful or desirable means of readjusting the burden of taxation and whether this given income tax will bring about the results sought, a new set of considerations makes its appearance. That the burden of the old tariff and, to a large extent, that of the new one as well, falls upon the average man through the enhancing of the price of the goods he buys, can hardly be disputed. Placing a tax upon the incomes of persons enjoying an exceptionally large amount of individual revenue undoubtedly furnishes a means for redressing in some measure the unevenness with which tax burdens are distributed. Whether or not in practice the desired result will be gained is a question whose answer must depend very largely upon the working-out of the conditions under which the tax in question is shifted so as to determine its final incidence. By exempting persons with incomes up to $3,000 undoubtedly the main body of the population was freed from the direct burden of this phase of the tariff act. But, as will be seen, a considerable portion of this tax is likely to be shifted. It is at least open to question how far in practice the tax will actually result in relieving the classes it was intended to help, and just how far it will afford means of shifting the burden back again to the same ultimate class of consumers who now pay the tariff. That it was in the abstract a desirable method of correcting the unevenness of taxation now complained of, no one could reasonably question. That this particular income tax would bring about that result in practice was very much less certain.

II

As was noted in the first paragraphs of this discussion, the income-tax sections of the tariff of 1913 were the successors of a measure tentatively adopted by the House of Representatives a year earlier and known as the excise income tax. This excise tax was formulated prior to the adoption of the federal constitutional amendment providing for an income tax, but was intended as a genuine income tax. It was in fact the lineal predecessor of the income-tax sections of the tariff. A brief historical review of its terms will show, therefore, by what gradual stages the final provisions were developed.

The excise income tax in the form at first adopted did not answer the purpose which it is desired to serve by the present legislation, for the following reasons:

1. It failed to make any adjustment with the existing corporation tax.

2. It was based upon a plan of legislation framed prior to the adoption of the income-tax amendment.

3. It was defective in principle and detail at many points.

All these difficulties it was felt should be considered in framing a new law and it seemed necessary to begin (*a*) by repealing the corporation tax, on the ground that, as an inclusive income tax is to be adopted, it should bear upon all income, not merely upon that of corporations, and not upon their income except in the same degree as upon other incomes; (*b*) by laying aside the older excise income tax in the form in which it was put through the House, and making a completely fresh start.

When the ground had thus been cleared it was planned to map out a general income-tax measure upon the principles now recognized in financial literature and embodied in European income-tax systems, adjusting such tax, however, to the state systems of revenue in so far as circumstances would permit. The chief points to be disposed of were as follows:

1. The fundamental necessity in income-tax legislation, it was believed, is to arrange wherever possible for the collection of the revenues at the source from which they are drawn. The excise income-tax bill of the preceding session did not satisfactorily do

this. It was therefore open to serious criticism. The excise income tax called fundamentally for an annual return to be made by the individual with reference to his income, after deducting a minimum of exemption and certain allowances for expenses and offsets. This of course threw the whole burden upon the accuracy with which return was made by the person who was to pay the tax. Experience unfortunately shows that taxpayers cannot be relied upon to be honest under such conditions and that they ought not to be subjected to the strain, as the effect of such strain is to penalize the honest man or the relatively honest man and to aid correspondingly the man of questionable integrity. It was admitted to be a doubtful question how far the principle of collection at the source can satisfactorily be extended by the federal government, but it was seen that the plan certainly could be carried to a far more advanced point than had been done in the excise income-tax bill. In that measure it was applied to some incomes, as seen in section 5 of the original bill whereby officials in the employ of the government were to have the tax deducted from their income and whereby corporations, etc., were to make returns in certain cases. This principle is the only effective one in connection with income taxation and it was felt that it should be applied as broadly and thoroughly as the Constitution and laws of the federal government would possibly allow. There was no weaker feature in the excise income-tax bill than this very failure to do what was needed toward insuring the successful levying of the tax by making certain that all doubt so far as possible was eliminated with respect to the accuracy of tax returns. It was thought that the principle of collection at the source could be applied in the following classes of cases at least:

(*a*) All corporations doing an interstate business, interpreting the word interstate in the broadest possible manner.

(*b*) Other classes of corporations chartered under federal law, e.g., national banks.

(*c*) Other classes of corporations over which the United States might in any manner be deemed to have the power of requiring information, or which act as agents for the performance of governmental functions.

(*d*) Other classes of business, not incorporated, falling within any of the above groups.

(*e*) Persons having to do with the collections of rentals or incomes arising from lands.

(*f*) Persons having to do with the registration and enforcement of legal instruments securing debts contracted on the strength of lands.

It was thought that if the principle of collection at the source could be applied to these and perhaps to other payers of interest, dividends, wages, and rents, the ground would be very largely covered, and the field remaining to be dealt with solely through individual returns would be relatively small.

Of course in this connection the difficulty had to be faced that the persons who pay such interest, dividends, wages, or rents would not know whether the people to whom they pay these incomes are or are not within the limit of exemption. For example, if the Pennsylvania Railroad is called on to deduct an income tax from the earnings of its bondholders before paying their interest, a case like this might arise: A may own Pennsylvania Railroad bonds sufficient to entitle him to interest of, say, $6,000, while B may have an equal income from various bonds, of the Pennsylvania and of other railroads. In that case, presumably, the Pennsylvania would deduct the tax on A's interest and would not deduct it on B's, while the other roads would not deduct anything from B's interest because B did not get from any one road an income in excess of the exemption. This could be met only by providing that the tax should be collected in every case and that a voucher should be supplied to the person from whom the money was thus taken, or that when interest was paid a record of ownership should be required. Then this person should be allowed to collect back from the government the sums cut off from his income if such income was clearly shown to be below the exempted minimum, or he should be compelled to pay in future if the tax were not deducted at the time the interest was paid. This would also call for a statement on the part of the individual which might or might not be true, since he would have to show that his income was within the minimum. Thus there might be a field for dishonesty there,

but it would be greatly limited. The plan, it was seen, would be inquisitorial without a doubt, but it was recognized that all income taxes are so, and the more effective they are the more inquisitorial they are.

2. It was desired that the question of interference with state taxes should be very carefully safeguarded. For some years past several states have had income taxes, many of them inefficient, and falling back upon exactly the sources of revenue that were to be drawn upon by the proposed act. Few legislators thought it would be a wise plan that would allow the double taxation of such incomes. In some way, it was believed, the field ought to be shared with the states. The best way to do this seemed to be to allow an offset in those states that have income taxes, equal to the amount paid in such states upon those portions of income which are in excess of the minimum exempted under federal law. A state receipt would release the taxpayer from the payment of the federal tax to the extent that the state tax coincided with the federal; but this allowance could be made only in those states that already had tax laws that duplicate the federal income tax, and the plan could not be so applied as to allow the states to pre-empt this field for all future time. This, it was thought, was a matter requiring to be worked out in a good deal of detail; but in the final form of the act provision was made only for the general deduction of state and municipal taxes in computing income.

3. There was also a strong feeling that the minimum of exemption provided under the old bill ($5,000) was too high. A study of incomes showed that the number above $5,000 is not nearly so great as many persons would suppose, and that this exemption might well be lowered to, say, $4,000. It was urged that if necessity required it, $3,000 would not be unreasonable. The whole question of exemption, it was felt, needed to be considered with very great care in order not to impose the tax upon portions of income that are not properly taxable at all, and at the same time to avoid exempting incomes that ought to pay the tax. An insufficient amount of study had been given to this subject in nearly all efforts at federal income-tax legislation. Moreover, in section 2 of the old excise income-tax bill, the exemptions or

deductions provided were exceedingly loose, particularly with respect to losses, while the provision that the taxes paid to state and municipal governments might be deducted in computing incomes was hardly fair.

4. In so far as the tax was to be applicable to corporate incomes, it was also desired that special care should be taken with its adjustment, the first question considered being how far to go in taxing corporations as artificial persons, if arrangement had already been made for taxing the individuals who composed or owned such corporations. Various legislators urged that if it was decided to impose the tax not only on individuals but on corporations, the corporation-tax sections of the existing law should be revised with great care with a view to taking advantage of the criticisms which experience had developed and eliminating as much as possible the basis for them. A good deal of the relative success of the corporation tax of 1909 had been due to the set of regulations worked out by the Secretary of the Treasury, but it was generally admitted that these regulations exceeded the Secretary's authority, and that in so far as they were good they should be embodied in legislative form and not left to stand merely upon executive orders.

5. A suggestion made but never acted upon concerned the solution of the foreseen and unforeseen difficulties and problems inevitable to the operation of the tax. Those who favored the careful application of the law urged that it would be a good thing, should it be deemed practicable, to create an income-tax commission or board consisting of expert persons who should act in an advisory capacity and be paid a purely nominal salary, reporting at the specified dates with reference to any changes needed in the technique of the law.

III

Some attention may now be given to the form actually assumed by the income tax. No attempt will be made or need be made to consider abstract questions affecting the desirability of progressive taxation or the abstract problem of an exemption minimum as a logical feature of income taxation. These subjects have been abundantly dealt with by writers on income taxation who have considered the general aspects of the problem with a fulness that

leaves little to be required. Some specific questions affecting the present income tax must, however, be considered.

First among these is that of the exemption. Was it wise to adopt a high exemption limit, and, if so, were the exemptions of $3,000 annual income for unmarried men and women and $4,000 for a family proper figures? A survey of state and foreign income taxes shows that the rate of exemption provided in such statutes is very much lower.

This high exemption cannot be defended on the ground that it was desired in that way to avoid conflicting with state income taxes since the act contains a distinct provision for avoiding double taxation through the payment of an income tax first to the state and then to the government. Nor can it be defended on the ground that $3,000 represents the minimum of subsistence. Even in the present day of the high cost of living, he would be a bold man who would contend that an unmarried individual could not exist on less than $3,000 per annum without impairing his efficiency, that being the usual argument put forward for the exemption of any portion of income. Neither could it be claimed that $3,000 was selected because of a belief that the cost of collection for incomes below that figure would increase in a geometrical ratio. As we must admit, the form and methods of the new income tax are of such a nature that collection might have been continued down to a very much lower income level without increasing in any appreciable degree the percentage of cost, dollar for dollar, necessary in order to get the funds into the Treasury. It is, of course, a well-known and generally admitted fact, even in a country so wholly lacking in reliable income data as is the United States, that only a comparatively small number of incomes relatively speaking amount to $3,000 or over. The only thing that seems reasonably certain is that, taken as a percentage of the total number of incomes, the ratio is very small. This means that the amount of revenue which can be collected by means of a tax of 1 per cent upon all incomes in excess of $3,000 or $4,000 as the case may be, bearing in mind that this minimum sum is deducted from every income before the amount payable is computed, will necessarily be relatively small. From these facts the necessary conclusion is that the so-called normal

tax of 1 per cent provided in the law will not in its working furnish a very practical source of support to the Treasury.

In like manner analysis may be made of the special income tax or "additional income tax" provided for in the act which calls for an extra 1 per cent per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000 and 2 per cent upon the amount by which the total exceeds $50,000 and does not exceed $75,000 and so on up to 6 per cent upon the amount by which the total net income exceeds $500,000. This application of the principle of progressive taxation is likely to return but little revenue, comparatively speaking. The progressiveness of the tax does not carry the maximum rate to so high a point as to render probable a resort to any elaborate devices for escaping the payment which would not be employed if only the normal income tax of 1 per cent were levied. Some such devices no doubt will be attempted but they would be resorted to in any case. While acquitting the additional tax feature of the law therefore of responsibility for any probable growth in evasions and while fully conceding that the machinery of collection is no more unwieldy or harsh in its operation as affecting the higher incomes than it is as affecting the lower, it must be concluded that the progressive feature is defensible only as a means of establishing a principle of taxation. If it was intended as a means of obtaining an extra return it should have been made much heavier; if it was intended to operate as a means of discouraging men from developing the higher incomes it did not go far enough, particularly as it stopped at $500,000 a year. It must therefore be regarded simply as a tentative experiment in progressive taxation made by men not thoroughly convinced perhaps of the wisdom of their own action, a tax which fails in any event to do much more than to irritate those upon whom its burden was expected to fall. These persons would in any case have been a very small group, if an influential one, an intelligent group in the main, able to understand the significance of a legislative step and quite as likely to resent it if it threw but a small burden upon them as they would be if the burden were very much heavier. It must therefore be regarded as unsatisfactory on the fiscal side and probably unwise on the political side. Like the normal tax,

and in much greater degree than the latter, the so-called "additional tax" must be regarded as having been established for the primary purpose of vindicating a general principle which had been accepted in theory by those who were engaged in framing the law.

As a final element in the general criticism of the exemption and additional tax provisions contained in the act should also be considered the portions of the measure relating to special deductions of exemptions to be made for the purpose of computing net income. Has net income in the law been properly defined? Has the definition been developed in such a way as to safeguard the interests of the income-tax payer and at the same time protect the Treasury? The language of the act with reference to the definition of income is as follows:

> the net income of a taxable person shall include gains, profits and income derived from salaries, wages or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividend, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income but not the value of property acquired by gift, bequests, devise or descent.

As exceptions to this definition or as exemptions from it, there are enumerated the proceeds of life insurance paid to the insured or his beneficiaries, necessary expenses involved in carrying on any business, interest on indebtedness, all other taxes, losses during the year (when not compensated by insurance) debts due ascertained to be worthless, reasonable allowance for wear and tear, income drawn from interest on state and municipal obligations as well as from those of the United States and its possessions, or (in the case of individuals) from dividends paid by corporations which had already paid the income tax.

This definition of net income, and the further limitation of its meaning through the elimination of the different classes of return there described, necessarily signifies very great difficulty in computing incomes upon an honest and sincere basis. The limitations

referred to are largely those which have been collected and assembled from the income-tax laws of various states. In those state laws the working of the provisions in question has usually been anything but satisfactory. Unquestionably the terms of the act in this respect will leave very large loopholes of possible evasion of the manifest intent of the legislation as a whole. If such exemptions were to be made it would have been much better to define and group them upon a more scientific basis, and so to limit them as to reduce the probabilities of evasion.

IV

While a discussion of the income tax from a technical standpoint would be of little service unless it were so protracted as to include consideration of the multitudinous regulations relating to the subject that have already been issued by the Bureau of Internal Revenue, a brief consideration of this aspect of the law which shall draw attention to its salient features is necessary. As already seen the income-tax law in contradistinction to its predecessor, the bill of the year previous which had been passed only in the House, sought to apply the idea of collection at the source with a moderate degree of thoroughness and inclusiveness. To this end it exacted in addition to the usual and necessary income-tax return called for from all regular payers of the tax, that is to say from all admitting or recognizing themselves as liable for the payment of the tax under the act as adopted, a return by all concerns which were in the habit of paying to given employees, creditors, or others sums of money in excess of the permitted exemption, or sums that might conceivably amount to more than such exemption. This idea of collection at the source evidently necessitated the use of all payers of rent, interest, or wages, as tax collectors if in any case they were parties to the payment of an income that was in excess of the specified minimum. Or as the act expressed it:

> All persons, firms, co-partnerships, companies . . . . in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees . . . . having the control, receipt, custody, disposal or payment of interest, rent, salaries, wages . . . . and income of another person exceeding $3,000

for any taxable year . . . . are hereby authorized and required to deduct . . . . such sum as will be sufficient to pay the normal tax imposed thereon by this section . . . . and they are each hereby made personally liable for such tax.

To apply this provision required naturally a very considerable amount of detail in the act itself and far more in the form of regulations of an administrative nature. These regulations and the difficulties and uncertainties growing out of them are the chief basis for discontent under the income tax and the principal ground upon which criticism of the measure is currently based. The dissatisfaction has been strongly expressed by many concerns which have been compulsorily obliged to act as revenue collectors and which, in order to carry on this function, have found themselves under the necessity of expending a good deal of money in the employment of clerks and employees of various classes. When attention is turned from this purely business point of view growing out of the unwillingness to spend more money than was actually necessary in the fulfilment of the obligations thus imposed upon the companies, it is seen that the chief ground of complaint in the larger sense must be taken to be that expressed from the standpoint of the individual himself. Such a complaint, embodying nearly all the serious criticisms of the technique of the law to date, was put into definite form by certain trust companies which have the duty of administering large incomes in New York City arising from estates intrusted to their care, and was filed on behalf of the individual income-tax payer early in February, 1914, by a committee acting for the companies.

The protest was based both on constitutional points and on features of the Form No. 1,040, provided for individual returns, which were held by the companies to be in conflict with the income-tax law. Several points were made against the regulations affecting the incomes of husband and wife, the view of the companies being that a wife's income should not be included with that of her husband, and should not be returned at all unless it amounts to $3,000. The protest was printed on paper of the same size as Form 1,040, so that it might be attached to the return filed, and institutions represented by the committee were supplied with

these protest blanks, for the use of their customers. The protest was addressed to the Secretary of the Treasury, the Commissioner of Internal Revenue, and the Collector of Internal Revenue for the district in which the return is filed. It said:

The undersigned, who, under protest and duress, has executed and verified the annexed "Return of Annual Net Income of Individuals," upon Official Form 1,040, as prescribed by the United States Treasury Department, protests against being required to make said return, and against its form, and against the assessment of any tax based thereon, or otherwise, against the undersigned under, or allegedly under, the provisions of Section II of the Act of Congress approved October 3, 1913, on the ground that the rights of the undersigned under the Constitution $\frac{\text{and}}{\text{or}}$ laws of the United States are thereby violated, and specifically, but not exclusively, on the following grounds of protest:

(1) That in so far as said Act $\frac{\text{and}}{\text{or}}$ the decisions of the Treasury Department require a deduction "at the source" from income and thus deprive the owner of such income of the use and benefit of the moneys so deducted, prior to the assessment of said tax against him, the same are in conflict with the V. Amendment to such Constitution.

(2) That the decisions of the Treasury Department $\frac{\text{and}}{\text{or}}$ the annexed form of return $\frac{\text{and}}{\text{or}}$ said Act, in so far as they contemplate a tax upon anything other than what is included in the word "incomes," as used in the XVI. Amendment to the Constitution of the United States, are contrary to law and to such Constitution, because, in so far as said tax is a direct tax, it is laid without apportionment among the States, and, in so far as it is an excise tax, it is arbitrary, unequal, not uniform throughout the United States, not within the taxing or other powers of Congress, and is in conflict with the V. Amendment to such Constitution.

(3) That the decisions of the Treasury Department $\frac{\text{and}}{\text{or}}$ the annexed form of return $\frac{\text{and}}{\text{or}}$ said act are contrary to law and said Constitution in so far as they require the inclusion, for the purpose of said tax, of income

(*a*)—received prior to October 3, 1913, such income having become principal assets prior to the passage of said act, and Congress being therefore powerless to tax the same without apportionment among the States;

(*b*)—accrued, in whole or in part, prior to the ratification of the XVI. Amendment to such Constitution by the Legislatures of three-fourths of the several States $\frac{\text{and}}{\text{or}}$ the certification thereof by the Secretary of State of the United States.

(4) That the decisions of the Treasury Department $\frac{\text{and}}{\text{or}}$ the annexed forms of return are contrary to law and said act in so far as they

(*a*)—fail to allow an exemption for the tax year 1913 of $2,500 or $3,333.33, as the case may be, with reference to the "additional" tax;

(*b*)—fail to allow, with reference to the "additional" tax, the deduction from gross income of "income derived from dividends on the stock or from the

net earnings of corporations, joint-stock companies, associations, or insurance companies subject to like tax";

(*c*)—require the inclusion of income received from fiduciaries, derived "from dividends on the stock or from the net earnings of corporations, joint-stock companies, associations, or insurance companies subject to like tax" or from "the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions";

(*d*)—require the inclusion in said return of income derived from "interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions";

(*e*)—require, with reference to the "normal" tax, a return of income "derived from dividends on the stock or from the net earnings of corporations, joint-stock companies, associations, or insurance companies subject to like tax";

(*f*)—require a return of income as "net income" without first allowing for the deduction of "income derived from dividends on the stock or from the net earnings of corporations, joint-stock companies, associations, or insurance companies subject to like tax" and consequently call for a return by individuals not having a net income of $3,000 for the taxable year;

(*g*)—depart from the method of computation prescribed by said act as follows:

"That for the year ending December 31, 1913, said tax shall be computed on the net income accruing from March 1 to December 31, 1913, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for";

(*h*)—require the inclusion, among "income on which tax has not been deducted and withheld at the source," of income, the payment of the tax upon which has been assumed by debtors from whom such income is derived, such income being paid in full by the debtors to the individual without exemption being claimed;

(*i*)—require an individual having a net income of less than $3,000 for the tax year, March 1 to December 31, 1913, to make a return;

(*j*)—restrict the exemption for the tax year 1913 of a husband and wife, living together and having separate incomes, to a total joint exemption of $3,333.33 on their aggregate income;

(*k*)—require a joint or separate return from a husband and wife, living together and having separate incomes, when neither one has a separate income in excess of $3,000 for the tax year;

(*l*)—require a husband or a wife, having a separate net income of less than $3,000 for the tax year, March 1 to December 31, 1913, to make any return, or to include therein a return of the separate income of his wife or her husband, as the case may be;

(*m*)—require a husband or a wife having a separate income in excess of $3,000, to include in his or her return a return of the separate income of his

wife or her husband, as the case may be, or require the one not having a separate income in excess of $3,000 to make a return of his or her separate income;

(*n*)—require or permit the assessment of an "additional" tax, based upon the aggregate income of a husband and wife living together and having separate incomes, when neither one has a separate income in excess of $20,000.

This may be regarded as a good epitome of the objections to the tax made from the individual standpoint and based largely on technical, legal, and fiscal grounds.

Apart from the question of methods of making return and the basis for complaint and criticism thereby afforded, probably the point at which the most extensive serious criticism has been visited upon the income tax from a technical standpoint thus far is found in its provisions with respect to exemptions. Many of these, such as those including fraternal beneficiary societies, and others, were of a distinctly political character; while alterations in favor of various special classes of insurance companies were the result of pressure which gained unwilling assent and compelled changes only at certain points, the balance of the enactment remaining practically unmodified. That these changes were not in all cases desirable was itself obvious; it is equally certain, even if less evident on the surface of things, that those which might be considered desirable became regrettable because they were not incorporated into the act in such a way as to become integral parts of it. They were, therefore, to be placed in the same category with the general exemptions, as provisions of an injudicious character tending to reduce the yield of the tax and damaging it in the logical aspect as a revenue measure without producing any corresponding results of a beneficial nature.

Without, therefore, undertaking to make detailed analysis of the conditions of imposition and collection of the income tax—an inquiry which in itself would be far too lengthy and complex for the present purposes, as well as impossible pending the accumulation of further experience—it may be said that the tax is nowhere more faulty than in its technique, and that while the idea of collection at the source must be regarded as absolutely indispensable to the successful operation of the measure, the mechanics of the

process by which this collection at the source is to be managed are far from satisfactory. That as a result of the defects referred to, coupled with the unavoidable irritation growing out of the imposition of any such tax, more or less litigation will almost certainly be instituted, and that even without such litigation considerable friction, difficulty, and evasion must be expected are obvious facts which can be ignored by no one. Undoubtedly those who drafted the legislation are fully alive to the imminence of these difficulties today. Probably they were aware of the prospects, even if less keenly so, when they put the measure forth.

V

In summing up, therefore, a somewhat varied verdict must be passed upon the income-tax sections of the tariff of 1913. Apparently this verdict may be expressed in substantially the following terms:

1. The tax itself was unnecessary except as a means of making up the loss of revenue from such items as sugar whose duties had been removed as a result of the general party opinion that they were unpopular and worthy of condemnation out of proportion to their actual burden.

2. Assuming that the removal, however, was to be effected and that a compensating revenue was needed, it could have been obtained with far less difficulty and friction than from the income tax.

3. The use of the income tax must be regarded in part, therefore, as a political vindication of the party, in part as the adoption of a measure to be employed in the future for redressing the balance of taxation and for furnishing a resource which can be relied upon to supply large quantities of revenue if necessary, while at the same time it brings home to the individual his responsibility for federal expenditures.

4. In this view, the income tax is not only a warrantable but a praiseworthy feature of the tariff law of 1913.

5. Nevertheless, it is not likely to be highly productive in view of the use of an unusually high exemption minimum.

6. Technically speaking, the law, although likely to be far more effective and successful than any law modeled upon the principle of self-assessment can be, is decidedly defective in technique and open to criticism, based (*a*) upon the inconvenience unnecessarily visited upon corporations and individuals, some of which has been mitigated by Treasury regulations but much of which will remain permanently; (*b*) upon the inconsistency and lack of careful workmanship found in numerous of its provisions; as well as (*c*) upon the admission of some flaws due to possibly unavoidable political pressure and agitation.

There seems to be little doubt that the benefits of the income-tax sections will be much more slowly realized than those of the other portions of the tariff, and that pending such realization the tax itself will result in throwing upon the act a very considerable burden of unpopularity in addition to that which it would otherwise have had to carry.

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